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ABSOLUTE SOFTWARE

B

COMPANY REPORT

HIGHLIGHTS

- Dividend yield of 2.3%
- Good growth driven by acquisition of NetMotion
- Management increased FY2023 guidance
- Long-term tailwinds from remote access requirements

September 29, 2022

Traded as:	ABST.TO(TSX)
Price:	C$15.83
Dividend:	2.02%
Debt:	HIGH
Market Cap:	$815.4 M
Beta:	0.74

REPORT CARD

INDUSTRIE	TECHNOLOGY	
METRIC	**VALUE**	**GRADE**
Expected 1 Year Revenue Growth	17.74%	B+
5 Yr. Revenue Growth	15.7%	A-
10 Yr. Revenue Growth Rate	10.2%	B+
5 Yr. ROE	-67.2%	C/C-
Gross Margin	81.4%	A+
Net Margin	-12.4%	C/C-
Current Ratio	0.8x	B-
Debt/Equity	86.6x	C/C-
Insider Ownership	1.97%	B-
5 Yr. Dividend Growth	0.00%	N/A
Qualitative	Solid ARR Growth and Outlook	B
Rating		B

COMPANY PROFILE

Absolute Software (ABST) is a cloud-based software company that focuses on secure access solutions and self-healing endpoints for the globally distributed workforces of today. The company has more than 17,000 customers and its endpoint platform is embedded in over half a billion devices across the globe. Its platform allows for visibility, control, and self-healing capabilities to its connected endpoints, and its aim is to be the most trusted security company that helps customers ward off cybersecurity threats. The company has evolved its technology but also how it uses its technology over the years as market demand and opportunities have evolved. With the rise of remote work and hybrid work solutions, the company has witnessed a change in how businesses need and use security solutions. ABST's customers include a variety of businesses in different industries and sizes, and it currently caters to the healthcare, education and public safety, government, financial, legal, and professional consulting industries.

REVENUE MIX

Absolute's platform has three main operating segments: its Persistence, Intelligence, and Resilience platforms. Its Persistence platform consists of an always-on technology which is connected to over half a billion global endpoints and allows for self-healing if a cybersecurity breach occurs. Its Intelligence platform allows for its customers to receive analytic insights and diagnostics on its own networks. The company's Resilience platform has three main segments, being its Secure Endpoint product portfolio, which allows IT teams within organizations to monitor laptop problems and for them to self-heal, its Secure Access portfolio, where end-users access data centers and files in the public cloud, and its licenses aimed at Independent Software Vendors (ISV) to ensure their applications remain healthy.

The company generates most of its revenues from the US, representing 77% of its total revenues, 2% are from Canada, and 21% are the rest of the world. Within its major business segments, 95.0% of its revenues come from its cloud-based services, 1.9% from the professional services segment, 0.4% from software licenses, and 2.0% are classified as Other. Enterprise and government clients represent most of its revenues, at 78% of total revenues, whereas education represents 22%. Its Secure Endpoint products are provided in the way of a Software as a Service (SaaS) model where clients access the software through the cloud. Customers purchase a term license ranging from one to five years. Its Secure Access solutions have historically been issued through a software license and maintenance model to a recurring subscription model.

GROWTH PLANS

The company has made good progress in expanding its operations globally and recently launched its operations in Australia and New Zealand this past April, and has been expanding across Europe, the Middle East and Africa. Throughout the pandemic, the company witnessed a large influx of demand from the education industry, as both teachers and students needed to access secure networks remotely. ABST is expecting to see growth in its education vertical slowing down as learn-from-home begins to normalize, and management sees a large growth opportunity in its enterprise and government verticals. Over the coming years, the company is expecting to invest heavily in the sales, marketing, and product development in these markets. Management noted that it is beginning to see larger deals flow through its sales pipeline from some of the largest global institutions. The CEO, Christy Wyatt, provided some context in the Q4 2022 earnings call into a few customers that have expanded their relationships with Absolute. A large professional services firm with over 100,000 endpoints (laptops, cell phones, etc.) expanded their relationship with ABST by using Absolute's Persistence platform on all their devices. A global mid-market investment bank is now using the company's Secure Access cloud as a part of their network architecture. Management increased guidance for adjusted revenue to be in the range of $241.5 million to $246.5 million for FY2023, representing an annual growth rate of 14.8% to 17.1%, and adjusted EBITDA to increase between 21% and 24%.

VALUATION

Shares of the company saw a rapid decline in 2021 as the company began missing on earnings estimates, however, the company has since seen a rebound and its shares are up ~15% year-to-date. The stock has been on an increasing trend over the past decade as more enterprises are requiring security solutions and increased protection against cybersecurity threats and the company has seen increased demand for its products. ABST trades at a 14.0X forward EV/EBITDA basis, which is at a discount to its peers in the software space. In relation to its sales, the company trades at a 2.3X forward sales multiple, which is also at a discount to its peers and is at a level that we feel is objectively undervalued for the cybersecurity industry. ABST's cybersecurity peers trade at an average 5.0X forward sales, whereas ABST trades at 2.3X, and the company has demonstrated progress towards profitability whereas other security names may be farther from achieving net profits. We feel that this may not necessarily imply ABST reaches its peers' average of 5.0X sales, but if it can achieve profitability, it is looking quite attractive relative to peers. Historically, the company has traded at a 4.1X price to sales multiple over the past two years, and we feel that this is a more appropriate level for a company operating in the fast-growing industry of cybersecurity.

RECENT FINANCIAL RESULTS

The company recently reported its fourth quarter results, ended June 30, 2022, where it saw revenues of $197.3 million, an increase of 63% year-over-year and a net loss of $24.5 million compared to net income of $3.7 million for the prior year. A substantial portion (78%) of the total increase in revenues are attributable to the acquisition and integration of NetMotion. The decline in the company's net profits for the year are largely driven by a decrease in gross profit margin as ABST had to incur additional costs for integrating NetMotion, namely increased headcount and amortization for the acquired technology and an $18.9 million interest payment on its long-term debt. ABST has roughly $264 million in long-term debt from the acquisition of NetMotion. For FY2022 its ARR increased by 70% over the prior year, which was primarily led by gains in its Enterprise and Government sector.

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ABST has demonstrated solid growth over the years, with a five-year revenue CAGR of 16.7%, and a 10-year revenue CAGR of 10.2%. It also pays a dividend yield of 2.3%, which we find to be rare for software companies, and shows that the company is committed to growing profitably and rewarding shareholders. Following the acquisition of NetMotion, we are expecting to see the company's gross profit margins improve in the coming years, which should help the company become profitable again. The company does intend to invest heavily in the sales, marketing, and product development for its enterprise and government segment, which we believe is a good strategic move given the expansion in ARR in this segment.

KEY RISKS

The company faces risks from the macroeconomic environment in that changes to businesses spending behaviours might negatively impact the future sales and implementation of Absolute's software. Changes in security requirements by educations or government industries can also have a material negative impact to the future revenue growth of Absolute. The failure to properly acquire and integrate future companies may have a detrimental impact to ABST's financials. The company has acquired a large amount of debt from its NetMotion acquisition, and as such, a 1% increase in LIBOR (akin to a prime rate) will increase the company's annual interest expense by $2.75 million.

SUMMARY

Absolute Software has demonstrated that the long-term demand for cybersecurity products and self-healing technology is evident, and while the pandemic pulled forward some of the sales of its products, we believe the continuation of work-from-home and hybrid work dynamics will act as tailwinds. We feel that ABST is at an attractive valuation today, has demonstrated a good history of revenue growth, and offers shareholders value through a 2.3% dividend. At the same time, the company did operate a net loss for the year, brought on by increased integration costs and interest expenses, and now with the acquisition of NetMotion has a high debt burden to carry. We believe that the company is capable of servicing both its interest and dividend payments and can achieve profitability as it becomes fully integrated with NetMotion. The company has shown that its services are needed, and while we would like to see management achieve profitability and actively work on reducing its debt load, we feel that shares are attractive at this valuation. Maintaining rating at 'B'.

KEY TAKEAWAYS

STRONG REVENUE GROWTH

HIGH DEBT BALANCE

ATTRACTIVE VALUATION

B

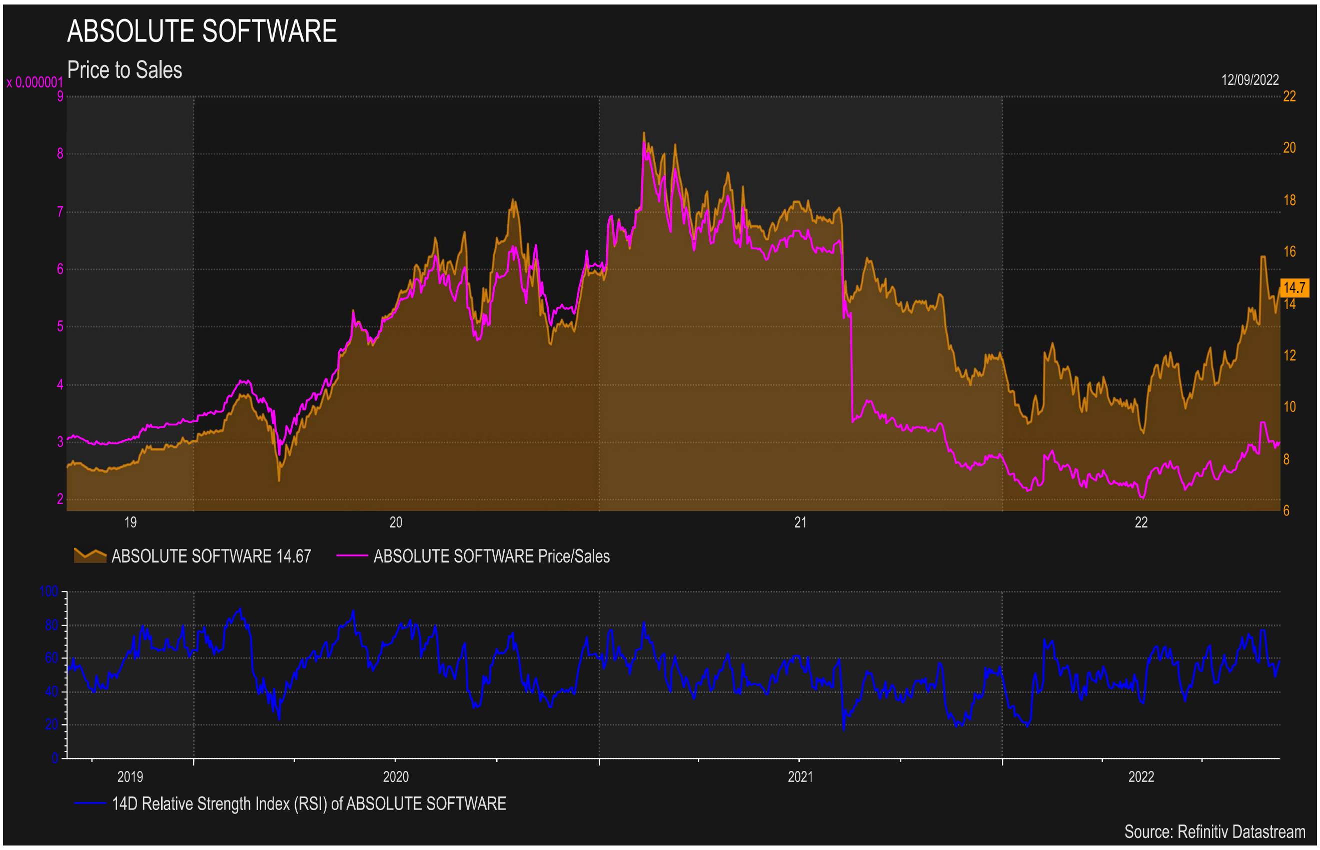
Absolute Software Corp (ABST.TO)

Scenario	DCF Model	H-Model	Relative Valuation	Historical Valuation
Model Price	$ -	$ 17	$ 23	$ 14

Current Price	$14.7	Risk Level	High		
Final Model Value	$17.8	Implied Return	21%	Impl. Total Return	23%

Key Stats

General		Growth		Profitability (Margins)		Financial Health		Valuation	
Market Cap	$750.0M	5-Yr Rev.	16%	Gross Profit	81.3%	Current Ratio	0.8	P/S	2.4X
Insider Ownership	1.97%	5-Yr EBITDA	25%	Net Profit	-12.4%	Debt-To-Equity	86.63	P/E	-
Dividend Yield	2.2%	5-Yr Net Profi	10%	EBITDA	15.9%	Debt Service	1.5	P/B	-



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BUY	A+	We expect very few A+ ratings. This would represent a near perfect stock. This is a great company in good or bad markets.
	A	A great company over long timeframes, with strong fundamentals and management. Near perfect, but missing one or two factors.
	A-	Similar to an 'A', with one or two small areas that could be improved. A great company, sensitive to external factors.
	B+	Fundamentally strong. Usually a great company in a bad sector. Good for the long-term, but some risks exist.
	B	Some fundamental issues, but still strong. Likely to face risks outside company control. A good company with less financial flexibility.
	B-	A company with higher risk or declining results. Likely to be volatile. Often a company in transition, for better or worse.
HOLD	C+	A company we do not expect much growth from. It may pay a dividend that we would view as sustainable, in which case we would own for income, but this company needs to be watched closely.
Sell	C/C-	Typically, this is a bad company with deteriorating results. It may have some turnaround potential but generally this is a name to avoid.
	D+/F	There are very few positives to this company. Use this company as a case study on what to avoid.

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